Alberta

MUNICIPAL AFFAIRS

Innovative Housing Grants Program

RESERVE FUND SYMPOSIUM

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The views and conclusions expressed and the recommendations made in this report are entirely those of the authors and should not be construed as expressing the opinions of Alberta Municipal Affairs.

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FOREWORD

The project documented in this report received funding under the Innovative Housing Grants Program of Alberta Municipal Affairs. The Innovative Housing Grants Program is intended to encourage and assist housing research and development which will reduce housing costs, improve the quality and performance of dwelling units and subdivisions, or increase the long term viability and competitiveness of Alberta's housing industry.

The Program offers assistance to builders, developers, consulting firms, professionals, industry groups, building products manufacturers, municipal governments, educational institutions, non-profit groups and individuals. At this time, priority areas for investigation include building design, construction technology, energy conservation, site and subdivision design, site servicing technology, residential building product development or improvement and information technology.

As the type of project and level of resources vary from applicant to applicant, the resulting documents are also varied. Comments and suggestions on this report are welcome. Please send comments or requests for further information to:

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APPENDIX A: TRANSCRIPT OF SYMPOSIUM PROCEEDINGS (NOT INCLUDED IN THIS DOCUMENT) -- APPENDIX A IS AVAILABLE UPON REQUEST FROM THE INNOVATIVE HOUSING GRANTS PROGRAM, ALBERTA MUNICIPAL AFFAIRS, 9925 - 107 STREET, EDMONTON, ALBERTA, T5K 2H9, OR PHONE (403) 427-8150.

1.0 INTRODUCTION

Recent years have witnessed a growing awareness amongst condominium involved professionals regarding the need for condominium associations to maintain reserve funds in order to meet major repair expenditures on an organized basis as opposed to enduring the problems and fiscal shock of special assessments. However, there has been a lack of coincidence of opinion as to the purposes of reserve funds, the approach to calculation of reserve funds and appropriate methods of raising funds to required levels. This variance has generated confusion within the condominium community as to the purpose and actual need for reserve funds.

Involved members of the Alberta Chapter of the Canadian Condominium Institute perceived a need to review the wide range of issues and concerns pertinent to condominium reserve funds, and to the extent possible, to develop a united industry position on actions required to resolve questions surrounding reserve funds.

Accordingly it was decided that a symposium be held, bringing together experts from across Canada and the United States along with prominent professionals from Alberta to examine and discuss the reserve fund issue.

The symposium to review condominium reserve funds was held October 28, 1988, in Edmonton with financial assistance from the Innovative Housing Grants Program of Alberta Department of Municipal Affairs.

The specific objectives of the symposium were to bring together prominent professionals involved in the condominium field, representing a wide range of viewpoints with the express purpose of clarifying the purposes of reserve funds, and the most appropriate methods for calculating reserve

funds, determining required funding levels and maintaining such levels for the condominium community. The symposium was directed to focus on achieving consensus where possible and to clarify the basis of differences where these exist.

1.1 Symposium Participants

The symposium participants were chosen based on prominence and expertise in the condominium field, in particular expertise that is related to the creation and maintenance of reserve funds and to obtain representation of the various professional viewpoints. The symposium participants were:

H. I. Shandling, Q.C.	Chairman
R. Wyndhamsmith	Consultant
M. Dingham	Assistant Commissioner Real Estate (California)
P. Leong	Engineer Reserve Funds
R. Ogle	Engineer Reserve Funds
R. Zemp	Engineer Reserve Funds
P. Achtem	Condominium Reserve Funds
W. Rhind	Financial Consultant
S. Patershak	Actuary
L. Cornelius	Actuary
D. Pavlich	Solicitor, Condominium Practice
M. Freedham	Solicitor, Condominium Practice
R. Clarke	Solicitor, Condominium Practice
E. Mirth Q.C.	Solicitor, Condominium Practice
D. Kramer	Solicitor, Condominium Practice
D. Irvin	Chartered Accountant
M. Hanington	Condominium owner/manager
M. Weleman	Condominium manager
D. Kassian	AMHC - Lender
D. Dennis	CMHC - Lender

The chairman was Mr. H. I. Shandling, Q.C., senior partner with the law firm of Duncan & Craig. Mr. Shandling is actively involved in a corporate commercial practice and has taught corporate law at the Faculty of Law at the University of Alberta.

Richard Wyndhamsmith is a real estate consultant from the State of California. Mr. Wyndhamsmith is President of Condominium Research Corporation. He has published a number of books on reserve fund studies including one widely used in Alberta called Reserve Fund Study Guide Lines and Condominium Budget Guide Lines.

Marty Dingham is the Assistant Commissioner of Subdivisions for the State of California. His department is in charge of the administration of condominiums and their reserve funds. Reserve funds are mandatory under California legislation.

Peter Leong is a civil engineer with Medhurst, Hogg, Sobbotka & Associates of Toronto. Medhurst, Hogg, Sobbotka & Associates have been specializing in engineering services for condominiums as well as reserve fund studies for the past 14 years.

Richard Ogle is a civil engineer at the Edmonton office of Morrison Herschfield Limited. While primarily a structural consulting engineering firm, Morrison Herschfield offers reserve fund studies as a service to their clients.

Robert Zemp is an engineer with Wardrop & Associates Ltd. in Edmonton, Alberta. Wardrop has been involved in preparing reserve fund studies for a number of years.

Peter Achtem is managing director of Condominium Consultants Canada Ltd., a firm he created to do professional reserve fund studies for the condominium communities in Alberta.

William Rhind is an assistant Vice-President with Guaranty Trust. He holds the position of Director of Condominium Services and has been in charge of putting together of financial services for the condominium industry.

Shannon Patershak is a consulting actuary with the firm William M. Mercer. Ms. Patershak has expertise in the funding of pension plans.

Lou Cornelius is a pension actuary with the Edmonton firm B.N. Shepp and Associates. His expertise has been in applying pension techniques to the calculation of reserve fund requirements.

Dennis Pavlich is a Professor of Law at the University of British Columbia. He has written a text on the subject entitled Condominium Law in British Columbia.

Mark Freedman is a partner with the law firm of Gordon, Traub & Rotenberg in Toronto, Ontario. Mr. Freedman specializes in the field of condominium law acting mainly for developers and lenders.

Ron Clarke is a lawyer from Calgary, Alberta. He was the President of the first condominium development constituted in Southern Alberta and is the current National Chairman of the Canadian Condominium Institute.

Emmanuel Mirth Q.C. is a partner in the law firm of Reynolds Mirth Richardson & Farmer. Mr. Mirth has been active in condominium law since 1968 with his involvement being largely concentrated in the development of condominiums.

Donald Kramer is a partner with the law firm of Duncan & Craig. Mr. Kramer's practice includes active representation for over 125 condominium corporations in the metropolitan Edmonton area.

Doug Irvin is a partner with the accounting firm of Thorne Ernst Whinney. He has been actively involved in doing audits for condominium corporations for 10 years.

Marc Hanington is a condominium owner and administrative member of the board of managers in a 60 unit project in South Edmonton.

Mannie Weleman is a property manager with the firm of PMR International Ltd. of Edmonton, Alberta. His company manages over 20 condominium corporations in the metropolitan Edmonton area.

David Kassian is the Executive Director of Marketing (Loans) with Alberta Mortgage and Housing Corporation. He has been actively involved with condominium corporations for several years.

Doug Dennis is the Provincial Director at Canada Mortgage and Housing Corporation and has 17 years experience in condominium lending.

In addition interested members of the public were present and were invited to interact with the panel.

1.2 Organization of The Report

Section 2 defines reserve funds and presents the main issues and provides a flavour of the symposium discussion.

Section 3 presents the recommendations of the symposium.

Section 4 presents concluding remarks.

1.3 Findings

The reserve fund symposium in Edmonton was the first assembly of such a range and depth of condominium expertise to be held anywhere. Other symposiums and conferences have been held to deal with condominium issues in general. The Alberta Reserve Symposium is the first known to research in depth the problem of replacement reserve funds and to make recommendations to facilitate legislative action that owners, financial institutions and corporations can adopt and be comfortable with.

The recommendations of the symposium panel have been ratified by the Alberta chapters of the Canadian Condominium Institute and will be included in the representations being made for changes in the legislation.

2.0 ISSUES DISCUSSED

Condominium Reserve Funds are funds created to repair or replace those components of the common property that will deteriorate, or wear out requiring replacement during the life span of the property. Expenditures from the reserve fund shall only be made for the repair or replacement of those components of the property which are not budgeted for repair or maintenance on a yearly basis.

There are no legal requirements in the present Condominium Property Act to have a reserve fund. Generally the reserve fund is a requirement of the bylaws of the corporation, however the vast majority of the bylaws are silent on how the fund should be established and what criteria should be used in determining the proper amounts required. However, condominium directors have a responsibility to ensure that a project is properly maintained and reserve funds provide a recognized vehicle to accumulate funds for replacement of hidden components as they wear out.

Much of the discussion of the symposium revolved around the question of whether legislation making reserve funds mandatory was required and, if so, the terms of legislative changes.

There was substantial agreement that owners who are second and third purchasers should not be penalized by immediate extraordinary assessments for the past inexperience or negligence of boards in creating a proper maintenance and repair fund, or the lack of direction in the Alberta Condominium Property Act in requiring that a reserve fund be established in an orderly manner by the corporation.

However, it was also felt that the required legislation should take into account that each condominium project is

unique in its own way. The determination of the reserve fund would have to depend on the individual project.

Panelists agreed that revisions to the Condominium Property Act should require each board of managers to create an orderly assessment or inventory of the common property. However, it was felt that that the assessment could be done by owners themselves following a pattern and calling on qualified tradesmen to give estimated costs on replacement of various components of each building or buildings or via a professional reserve fund study done by a qualified professional engineer who would carry out an inspection, quantity survey and pricing. The board could either instruct the engineer to do the calculations to arrive at the reserve fund dollar requirements or the board could consult with an actuary to do the calculations required on the basis of the engineer's report.

The panel felt that the type of reserve fund study done should be left to the boards of managers as there were concerns that engineered studies tend to be too conservative and often do not reflect maintenance considerations properly. An example of this is asphalt shingle roofing. Numerous projects have their roof shingles checked twice each year, spring and fall. Checks of this nature done properly, will have damaged or broken shingles replaced, all flashings tightened and will generate a report to the board of managers on the condition of the roof on a continuing basis. Experience has shown that maintenance of this nature can extend the life span of the roof by fifty to sixty percent. With such a maintenance program calculated into the yearly budget, the required reserve fund contributions should be reduced.

Boards of managers have expressed concern and shock on receiving engineered studies showing massive short falls in

their reserve funds. The engineered cash flow presented with the studies generally calls for very substantial increases in condominium assessments.

The calculations for a reserve fund should be done by a qualified financial expert, such as an actuary. After all, a reserve fund relates to a pension fund for a condominium. An example of an actual study done by engineers showed an immediate increase of approximately 50% in reserve fund contributions to replace various deteriorating areas of condominium buildings. The same engineering estimates presented to an actuary resulted in substantially different contribution estimates. The actuarial table showed a required increase in contributions of 9.5% per year for three years and then a 3.5% per year increase spread over the next ten years. The engineering study and cash flow showed that, after the continuing replacements had been done and paid for during the time period, the condominium corporation would have $4,000,000.00 in the reserve fund. The same repairs completed using the reserve fund prepared by the actuary left a balance of $12,000.00 in the fund.

The symposium panel itself was unable to arrive at a determination as to the viable life of a project central to the basis of differences noted above. Buildings 30 years old in the United States are being demolished and replaced with new technologies, as the older buildings are no longer economically feasible to maintain or retrofit to current standards. Further discussions by the condominium community and engineering and actuarial professionals are required to resolve this matter.

The symposium panel contained a wide range of specialists, although the legal contingent on the panel tended to enforce a legalistic bias to the proceedings. The panel agreed that there should be some common approach to the resolution

of reserve fund issues. Discussions regarding the methodology of determining the type of reserve fund study required were extensive. A consensus of opinion emerged that a legislative mandate is required to ensure that reserve funds are mandatory for every condominium. The consensus was that the method of determining the amounts were to be left with the condominium corporation themselves, with the notation that every board of managers has a fiduciary duty to create a proper reserve fund for the future. The symposium participants agreed that the elected board of managers should have the responsibility to set the assessment for the reserve fund and that the owners at large should not give direction to the board in the matter of the amounts determined or assessed. Condominium fees and assessments are like taxes in that every individual objects to them, but they must be collected and paid for the common good of all the owners.

The symposium also indicated that the changes to the Condominium Act should lay some degree of responsibility on the lenders to ensure that the mortgagor pays all proper assessments in the same manner as municipal taxes.

The consensus of the panel was that certain details of the Ontario Condominium Act, specifically Section 36, be incorporated into any revisions to the Alberta Act except that the reserve fund shall be a calculated amount and no reference should be made to a percentage amount of the annual budget as referred to in Subsections 2 and 3 of the above section.

A number of other issues came out in the discussions, however, these were largely incidental to the central issues. The recommendations outlined present the range of symposium findings.

3.0 SYMPOSIUM RECOMMENDATIONS

The symposium developed a number of consensual recommendations which should go some way to clarifying the need and status of reserve funds. These are presented below.

1. At present, there is no obligation for condominiums to have a reserve fund. The panel was unanimous in recommending that there should be mandatory reserve fund legislation. It was accepted that in a few cases, reserve funds might not be needed; for example, a condominium project with a single owner or very small condominium project. The panel did not detail specific exceptions but did recognize that there should be exceptions.

2. Every condominium project is unique. Accordingly, the reserve required would vary depending on factors such as age, state of repairs and quality of construction. To determine these needs, a reserve fund study by engineers and other professionals is desirable. The panel came to the conclusion that reserve fund studies should generally be mandatory, recognizing that it is not practical in all circumstances to have one. The legislation would require a reserve fund study except in specified circumstances. Those panelists representing mortgage lenders felt very strongly on the need for legislation requiring a regular reserve fund studies.

3. The amount of reserve funds shall be calculated on the basis of expected repairs, replacement costs and life expectancy of components comprising the common property and assets of the condominium corporation. It was

suggested that Section 36 of the Ontario Condominium Act be used as a guideline in formulating the legislation. The general recommendation in this regard was unanimously agreed upon.

4. It was agreed and recommended that the responsibility for the amount in the reserve fund and its determination be left to the board of managers of the condominium corporation, and not be left to unit owners to decide.

5. It was generally agreed that the investment of reserve funds be dealt with in the same fashion as is contemplated under the Trustee's Act and Section 35 of the Condominium Property Act. No special trust fund should be created for the investment of reserve funds.

6. It was also the consensus of the symposium that reserve funds should not be protected from creditors and not be given any special status or be exempt from judgment execution.

7. The legislation should recognize that there has to be a catch up period for existing condominium projects, thus eliminating the immediate requirement for a corporation through its board to immediately fund an adequate reserve fund. Boards should take reasonable steps to implement and augment a reserve fund over a reasonable period of time.

8. All interest earned on invested reserve funds belongs to the fund and not to the owners of the condominium corporation. It would not be a matter for adjustment on closing of transfers of title, nor should passive interest income become part of the operating budget.

9. It was the recommendation of the symposium that the professionals doing reserve fund studies develop some standards on approaches to calculating reserve funds which are not to be mandated but which will result in some consistency in the establishment and reporting on reserve funds.

10. The reserve fund (and financial affairs) of the condominium corporation should be the subject of periodic audit.

11. The details of the reserve fund should be available to those who inquire, much in the same fashion as contemplated under Section 36 of the Condominium Property Act regarding financial statements, budgets, bylaws and minutes.

12. Those who have access to reserve funds should be bonded.

13. Section 23(4) of the Act should be expanded to offer protection to the board where their acts are bona fide in the handling and maintenance of a reserve fund.

4.0 CONCLUSIONS

The Canadian Condominium Institute North and South Alberta Chapters have reviewed the proceedings and recommendations. Members of the symposium panel, condominium boards and property managers were enthusiastic about the depth of the discussions. However, there is still reluctance to make a hard and fast recommendation as to which is the best method of determining the amounts required in the reserve fund. Further discussions are proceeding on this issue.

Ontario legislation sets a minimum percentage of the annual budget. Most boards and owners in Ontario seem to have determined that this is the only amount required to be contributed to a reserve fund. A minimum percentage meets the requirements of the legislation; however, in most cases it does not meet the requirements of the reserve fund.

The general recommendation of the panel was that legislation should be enacted requiring reserve fund studies be done by professionals in the industry, or by condominium corporations themselves. The study, if done by the board itself should be complete, and outline a long term maintenance/replacement program.

Boards of managers should take into account that any maintenance not done or budgeted for on a yearly basis should be considered a reserve fund expenditure. Expenditures for capital improvements such as additional fencing, landscape improvements etc. should be recognized as a separate budget item.

Once the reserve fund guideline has been established, expenditures from the reserve fund should only be made for repair or replacement of those components designated in the reserve fund plan. Other expenditures that are desired

should be budgeted for over a longer period of time. The reserve fund should be kept reasonably liquid and not pledged to secure a loan for any other improvement on a project. (The corporations under the present legislation are governed by the Trustee Act of Alberta as to what investments may be made for the reserve fund.)

The Canadian Condominium Institute has since its creation, given numerous seminars on reserve funds, their creation and administration. Institute representatives feel that they have been able to emphasize the importance of having an adequate reserve fund to approximately twenty percent of the condominium complexes in Alberta. The Canadian Condominium Institute is still striving to reach and educate the remaining eighty percent.

Surveys show that over sixty percent of the condominium corporations are still self managed. A review of some of these corporations shows that some eighty-five percent of these are severely underfunded. Reserve funds have only become a major concern since 1980 in Alberta. However, many condominiums in Alberta are reaching the twelve to fifteen year age bracket and will require some major component replacement in the near future.

A review of reserve fund studies that have been completed shows that there is a requirement to put an average of $220.00 per unit per year into reserve for the future, beginning from day one of the occupancy of the project. To roughly gauge the adequacy of the current situation, expenditures undertaken on reserve fund eligible expenditures would have to be calculated and deducted from the above. The remaining balance would show the shortfall required to catch up. While the above method is not entirely accurate it would give the corporations a rough

gauge of the adequacy of their current situation and a sense as to the need to undertake a proper study.

Where existing buildings are converted to condominiums the matter of appropriate reserve funds is even more problematic. Increasingly, buildings twenty to thirty years old are being converted to condominiums. The best years of the building have been used, and although they are cosmetically presentable, the new owners of units are not aware of deficiencies. The Alberta Condominium Property Act has always been silent on conversions, and, as such, owners who purchase units in a building of this nature are sometimes faced with horrendous repair costs shortly after conversion. There is no requirement in the Act for disclosure as to building condition. The recommendation to change legislation will include a section that will ensure a reserve fund study is included in the presentation to potential owners. A prudent person purchasing a condominium unit would be well advised to request a copy of a reserve fund study to compare with the financial statements.

The Canadian Condominium Institute has also formed a subcommittee of knowledgeable people to address the methods of calculating reserve funds. Engineered studies are expensive and to some extent the findings are beyond the grasp of the average layman. The subcommittee will consider approaches that a board of managers could use to prepare a guideline for future reserves.

One such source currently available is Condominium Reserve Study Guidelines, by Richard Wyndhamsmith. The book can be ordered through the Alberta chapters of the Canadian Condominium Institute.